Supreme Court, U.S.
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No. 92-664

In The

# Supreme Court of the United States

October Term, 1992

RONALD H. RILEY,

*Petitioner,*

v.

KINGSLEY UNDERWRITING AGENCIES, LTD., a British corporation, LIME STREET UNDERWRITING AGENCIES, LTD., a British corporation, BANKSIDE SYNDICATE LIMITED, a British corporation, FIRSTBANK OF VAIL, N.A., ROBIN C. KINGSLEY, ROBERT HALLAM, SOCIETY AND COUNCIL OF LLOYD'S, and JOHN DOES I through X,

*Respondents.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

## PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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## REPLY TO COUNTERSTATEMENT OF THE FACTS

Respondents' Counterstatement of the Facts frames the issue before this court. While the Securities and Exchange Commission (the "SEC") has concluded that Respondents' sale of investments in Lloyd's of London ("Lloyd's") is subject to the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"), the effect of the Tenth Circuit's decision is that it is not, thus operating to waive Mr. Riley's statutory protections under the U.S. Securities laws. This decision is contrary to well established holdings of this Court and the Congress.[1]

As Respondents point out, in 1987 and 1988 the SEC reviewed the issue of whether the sale of interests in Lloyd's falls within the scope of the Securities Act and the Exchange Act. The SEC determined that the sale of interests in Lloyd's "would be subject to all of the provisions of the Securities Act and the Exchange Act, *including the anti-fraud provisions.*" Respondents' Brief in Opposition, at RA-3 ("Respondents' Brief") (emphasis added).

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[1] Congress has mandated that substantive protections of the U.S. Securities laws cannot be waived by including anti-waiver provisions in both Acts. *See* Section 14 of the Securities Act (15 U.S.C. Section 77n) and Section 29(a) of the Securities Exchange Act (15 U.S.C. Section 78cc (a)) (collectively the "anti-waiver provisions"). Additionally, this Court has indicated that where, as here, choice of law and choice of forum clauses ("Choice Clauses") operate in tandem as a prospective waiver of a parties' right to pursue statutory remedies, this Court would have "little hesitation in condemning the agreement as against public policy." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 637, n. 19 (1985).

Respondents characterize their mass distribution of securities to U.S. citizens as having an "international character."[2] Respondents' Brief, at 1. However, each of Petitioner's claims arise from his purchase of securities from Respondents during the time period 1988 through 1990, and not before. All solicitations from Respondents during this time period were received by Petitioner in Colorado, by mail or by telephone, from England. The international character of the transaction arises only because Respondents are foreign issuers of securities operating in the U.S. The SEC opined that the "provisions of the Federal securities laws generally are applicable to the sales of foreign securities (*including participations in Lloyd's*) . . . . " *See* Respondents' Brief, at RA-4. (emphasis added). Contrary to the SEC's opinion, the impact of the Tenth Circuit's decision is that the Federal securities laws are *not* applicable to Respondents' sale of securities in the U.S.

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[2] Assuming each of the 2,900 U.S. Names who participated in Lloyd's invested the relatively low amount of £250,000 (Petitioner invested over £1,000,000 his last four years), Lloyd's raised in excess of One Billion U.S. Dollars in capital from U.S. investors. Respondents place great weight on the fact that "*if* the Members Agents solicited participation in Lloyd's in compliance with the procedures of the Commission's Regulation D," registration was not required. Respondents' Brief, at 1 (emphasis added). First, it is inconceivable that Respondents could raise $1 billion from U.S. investors and meet the requirements of Regulation D which relates to raising capital through other than a public offering of securities. Second, regardless of whether registration would be required, the anti-fraud provisions of the U.S. Securities laws would continue to apply.

## REPLY TO RESPONDENTS' OPPOSITION TO CERTIORARI

### I.

**Denial of the Petition for Writ of Certiorari Sets a Dangerous Precedent, in effect, Nullifying this Court's Holdings in *Mitsubishi, McMahon,* and *Rodriguez*.**

Respondents argue in their Brief that Mr. Riley's Petition should be denied because the decision of the Tenth Circuit to enforce the Choice Clauses, which waives substantive protections of the U.S. Securities laws, is consistent with this Court's holdings that Choice Clauses in international agreements must be upheld. To the contrary, the decision of the Tenth Circuit directly conflicts with the holding of this Court in *Mitsubishi,* wherein Justice Blackmun, writing for the Court, concluded that the Court would not hesitate to strike down Choice Clauses in international agreements, and condemn them as against public policy, if they operate in tandem as a prospective waiver of a party's right to pursue U.S. statutory remedies.[3]

Moreover, the Tenth Circuit's decision is directly contrary to the Congressional mandate in the anti-waiver

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[3] 473 U.S. 605, 637, n. 19. Respondents ignore this plain holding of *Mitsubishi,* instead arguing that *Mitsubishi* stands for the principle that public policy issues are ripe for application, if ever, only at the enforcement stage of arbitral or litigation proceedings. Such argument clearly misconstrues the holding of *Mitsubishi* in footnote 19. The Court in *Mitsubishi* clearly stated it would condemn the *agreement itself,* not the award, if there was a *prospective waiver* of the right to pursue statutory remedies. Since counsel for Mitsubishi had conceded that American law applied, and the antitrust claims had been submitted to the Japanese panel on that basis, the Court then did not need to speculate whether U.S. law would be displaced.

provisions of the U.S. Securities laws that any agreements "to waive compliance with any provision of [either Act] are void," and this Court's holdings in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), and *Gilmer v. Interstate/Johnson Lane Corp.*, ___ U.S. ___, 111 S. Ct. 1647 (1991), interpreting the same, that the substantive provisions of the U.S. Securities laws cannot be waived.

The Choice Clauses in the case at hand seek to apply English law. These Clauses clearly operate as a waiver of the substantive protections of the U.S. Securities laws, since Respondents would be exempt from claims for violations of the registration, disclosure, and anti-fraud provisions under English law by virtue of the Lloyd's Act and the Financial Services Act.[4] Respondents have completely exempted themselves through use of such clauses even though the SEC has flatly concluded that investment and participation in Lloyd's by a U.S. Name constitute a security. Respondents' Brief, at RA-3, 4.

The other cases relied upon by Respondents also do not support their argument. Respondents' Brief, at 4-10. The Choice Clauses at issue in *M/S The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) and *Carnival Cruise Lines,*

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[4] *See* Petition for Certiorari, at 13-15 ("Petition"). Respondents' argument that it is impossible to determine whether arbitration in England under English laws would ultimately infringe to an unacceptable degree upon Petitioner's rights is thus without merit. Moreover, Respondents' reliance on *Roby v. Corporation of Lloyd's*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,971 (S.D.N.Y. Aug. 18, 1992) is misplaced, as that decision, along with the Tenth Circuit decision, was decided directly contrary to the authority of this Court and Congress that substantive protections of the U.S. Securities laws cannot be waived.

*Inc. v. Shute*, ___ U.S. ___, 111 S. Ct. 1522 (1991) did not operate to deprive the respective parties of statutory rights, since no statutory rights were at issue. Moreover, *The Bremen* specifically recognized that Choice Clauses should not be enforced where to do so would contravene a strong public policy. 407 U.S. at 15; *see also* Petition, at 16-17.

Similarly, the clauses at issue in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) provided that Illinois law would apply; thus, potential waivers of statutory protections were not at issue. *See* Petition, at 17. The Court in *Howe v. Goldcorp Invs., Ltd.*, 946 F.2d 944 (1st Cir. 1991), *cert. denied*, ___ U.S. ___, 112 S. Ct. 1172 (1992), determined that, since only procedural and small differences in standards existed between Canadian law and American law, trial in Canada would not deprive the plaintiff of relevant substantive legal advantages. Finally, *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985) simply involved the possible collateral estoppel effect of an arbitration clause to another proceeding which is not at issue here.

Denial of Mr. Riley's Petition will, in effect, nullify the holdings of this Court in *Mitsubishi*, *McMahon*, and *Rodriguez*, as well as nullify the effectiveness of the anti-waiver provisions of the U.S. Securities laws, by allowing a decision of a Circuit Court to stand that is directly contrary to their explicit instructions without so much as a review by this Court. Further, denial would set a dangerous precedent by sending a clear message to foreign entities doing business with American citizens that they may avoid compliance with the U.S. Securities laws by the simple expedient of using Choice Clauses which provide for a less restrictive foreign law to apply. This Court

should thus grant *certiorari* to settle this important and far reaching question of federal law.

## II.

**The Arbitration Clause Cannot be Enforced Since it Operates to Contravene Fundamental United States' Public Policies.**

### A. The General Policies Supporting Enforcement of Arbitration Clauses do not Compel Arbitration in this Case.

Respondents have utterly failed to address this Court's directive as expressed in *McMahon*, *Rodriguez*, and *Gilmer*, that enforcement of an arbitration agreement cannot undermine the substantive protections afforded U.S. investors by the U.S. Securities laws.[5] *McMahon*, 482 U.S. at 230; *Rodriguez*, 490 U.S. at 481-82; *Gilmer*, 111 S.Ct. at 1653.

Where the arbitral proceedings will deprive plaintiffs of their substantive *statutory* rights, this court has flatly

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[5] None of the other cases cited by Respondents deal with arbitration of securities claims. *See* Respondents' Brief in Opposition, at 12-13. In fact, several of the cases cited do not even deal with the issue of enforcement of arbitration agreements, in general. *See Siderman de Blake v. Republic of Argentina*, 965 F.2d 699 (9th Cir. 1992) (dealing with Foreign Sovereign Immunities Act); *Ministry of Defense of the Islamic Republic v. Gould, Inc.*, 969 F.2d 764 (9th Cir. 1992) (dealing with the enforcement of an award from the U.S.-Iran Claims Tribunal); *McDermott Int'l, Inc. v. Underwriters at Lloyd's*, 944 F.2d 1199 (5th Cir. 1991) (dealing with removal rights); *Interamerican Trade Corp. v. Companhia Fabricadora de Pecas*, 973 F.2d 487 (6th Cir. 1992) (dealing with forum selection clause); *Paper Express, Ltd. v. Pfankuch Maschinen GmbH*, 972 F.2d 753 (7th Cir. 1992) (dealing with forum selection clause).

stated that such agreements would be void as against public policy. *Mitsubishi*, 473 U.S. at 637, n. 19; *see also McMahon*, 482 U.S. at 230. In the case at issue, this Court is faced with just that situation.

Mr. Riley signed, in Colorado, several pre-printed, form agreements with Respondents. One of those agreements, the agreement with his Member's Agents, contained a clause requiring arbitration of disputes in England, under English law.[6] As stated in the Petition, an English arbitrator faced with such an agreement would apply English law. Petition, at 13-15. Even assuming Mr. Riley could maintain a right to pursue Respondents on a theory of common law fraud, he is flatly precluded from bringing a claim for failure to register the securities under the Securities Act, and from bringing a claim pursuant to the anti-fraud provisions of the Securities Act and the Exchange Act. Mr. Riley benefits from strict liability for Lloyd's violations of the registration provisions and anti-fraud provisions of the U.S. Securities laws. Under English law, Mr. Riley must prove bad faith. Thus, Mr. Riley would be deprived of his statutory rights under the U.S. Securities laws if the Arbitration Agreement is enforced. Such a deprivation fits squarely within this Court's decision in *Mitsubishi*.

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[6] The only parties subject to the Arbitration Agreement are the Member's Agents. Lloyd's and the other Respondents are not parties to an arbitration agreement with Mr. Riley. Therefore, even if this Court decides that the Convention must prevail with regard to the Arbitration Agreement, such a decision would have no effect on the enforceability of the Choice Clauses present in the other agreements.

**B. The Convention does not Require Enforcement of Arbitration Agreements when Enforcement Would Contravene Fundamental Public Policies of the Forum State.**

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards requires the enforcement of arbitration clauses unless such clauses are "null and void, inoperative or incapable of being performed." 9 U.S.C. § 201, et seq. (the "Convention"). According to this Court, an agreement to arbitrate is "null and void" when it "contravenes fundamental policies of the forum state." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 530, n. 10 (1974); *see also Rhone Mediterranee Compagnia v. Lauro*, 712 F.2d 50, 53 (3rd Cir. 1983); *Meadows Indemnity Co. v. Baccala & Shoop Insurance Services, Inc.*, 760 F.Supp. 1036, 1043 (E.D.N.Y. 1991) (emphasis added). Respondents fail to even address this distinction in their Opposition.

Here, a fundamental public policy of the United States is contravened. This Court has flatly stated that the fundamental policy behind the Securities laws is the protection of the investor. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). For that reason, the Securities laws provide for strict liability for failure to register and for misrepresentations and omissions in the offering documents as well as a broad anti-fraud provision to prevent misrepresentations in the purchase and sale of securities.

Respondents have raised over one billion dollars selling securities in the United States to U.S. citizens. By virtue of a form arbitration agreement in their offering documents, Respondents now claim to be exempt from enforcement of the registration and anti-fraud provisions of the U.S. Securities laws. To allow foreign issuers, such as Lloyd's and its agents, to evade the protections of the

U.S. Securities laws by invoking the Convention would clearly circumvent the cornerstone of our Securities laws and constitute a judicially created exemption to an investor's strong remedies against the sellers of securities. This is clearly not the purpose nor the intent of the Convention and this Court should not allow it to be interpreted in such a way.

## III.

**The Decisions of the District Courts Conflict with each other and Conflict with the Holdings of this Court and the Mandate of Congress in the U.S. Securities laws.**

Petitioner does not contend, and has never contended, that *certiorari* should be granted because decisions of the Courts of Appeals are in conflict. Instead, Petitioner informed this Court in its Petition that decisions of the federal district courts are in conflict on this issue. Two of these decisions, *Bonny v. Society of Lloyd's*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,811 (N.D.Ill. Feb. 24, 1992) and *Roby, supra* were decided in accordance with the Tenth Circuit decision at issue herein that conflicts with *Mitsubishi, McMahon, Rodriguez,* and the anti-waiver provisions of the U.S. Securities laws, as discussed above. *See* § I, *supra*.[7] Since the district courts and the Tenth Circuit have decided an issue of far reaching consequence, and set important and dangerous precedents that are contrary to the holdings of this Court and

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[7] *Hirsch v. Oakeley Vaughan Underwriting, Ltd. et al.*, No. 89-2563, unpublished slip opinion (5th Cir. 1989) and *Howe v. Goldcorp, supra,* are not relevant to the case at hand, as they involved the issue of *forum non conveniens* which is not at issue in this Petition.

the mandate of Congress, Petitioner requests that this Court grant *certiorari* to settle the issue.

## CONCLUSION

For the reasons set forth herein, the Petition for Writ of Certiorari should be granted.

Respectfully Submitted,

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